Supreme Court, U.S.
FILED

97 868 NOV 24 1997

OFFICE OF THE CLERK

No. 97-

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

NACCO INDUSTRIES, INC.,

Petitioner,

v.

ROGER W. TRACY, TAX COMMISSIONER OF OHIO,

Respondent.

Petition for a Writ of Certiorari to the Supreme Court of Ohio

PETITION FOR A WRIT OF CERTIORARI

TIMOTHY B. DYK
(Counsel of Record)
GREGORY A. CASTANIAS
PAUL R. REICHERT
JONES, DAY, REAVIS & POGUE
1450 G Street, N.W.
Washington, D.C. 20005
(202) 879-3939

CHARLES M. STEINES
JONES, DAY, REAVIS & POGUE
North Point
901 Lakeside Avenue
Cleveland, Ohio 44114
(216) 586-3939

Counsel for Petitioner

QUESTIONS PRESENTED

Ohio's corporate franchise tax taxes gains on the sale of United States Treasury Bonds and other federal obligations, but excludes gains on the sale of comparable state obligations. This case presents the following questions:

1. Whether Ohio's discriminatory tax violates 31 U.S.C. § 3124(a), which bars "each form of taxation that would require the [United States] obligation, the interest on the obligation, or both, to be considered in computing a tax . . . ."

2. Whether Ohio's tax impermissibly discriminates against holders of federal obligations in violation of the intergovernmental tax immunity doctrine under the Supremacy Clause of the United States Constitution.

PARTIES TO THE PROCEEDINGS

The parties to the proceedings in the Ohio Supreme Court were NACCO Industries, Inc. and Roger W. Tracy, Tax Commissioner of Ohio.

Pursuant to this Court's Rule 29.6, NACCO Industries, Inc. states that it has no parent companies. NACCO Industries, Inc. owns 97.62% of Hyster-Yale Material Handling, Inc., which owns 100% of NACCO Materials Handling Group, Inc. In turn, NACCO Materials Handling Group, Inc. owns 20% of Yale Financial Services, Inc., and a 50% interest in Sumitomo-Yale Co., Ltd. (Japan). NACCO Industries, Inc. also owns The North American Coal Corporation, which owns partial interests in two Texas partnerships — approximately 36.7% of Dos Republicas Coal Partnership and 50% of Red River Mining Company.

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

PARTIES TO THE PROCEEDINGS ii

TABLE OF AUTHORITIES iv

OPINIONS BELOW 1

JURISDICTION 1

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED 1

STATEMENT 4

REASONS FOR GRANTING THE WRIT 10

I. IN HOLDING THAT THE OHIO TAX DID NOT VIOLATE 31 U.S.C. § 3124, THE OHIO SUPREME COURT MISINTERPRETED THIS COURT'S DECISION IN *NEBRASKA DEPARTMENT OF REVENUE v. LOEWENSTEIN* 10

II. CERTIORARI SHOULD BE GRANTED BECAUSE THE OHIO SUPREME COURT'S DECISION CONFLICTS WITH THIS COURT'S DECISION IN *MEMPHIS BANK & TRUST CO. v. GARNER* 16

III. THE ISSUES PRESENTED BY THIS CASE ARE IMPORTANT 20

CONCLUSION 22

TABLE OF AUTHORITIES

Page

Cases

American Bank & Trust Co. v. Dallas County, 463 U.S. 855 (1983) 11, 12, 13, 14
Barker v. Kansas, 503 U.S. 594 (1992) 16
Brotherhood of Railway and Steamship Clerks, Freight Handlers, Express and Station Employees v. Allen, 373 U.S. 113 (1963) 16
Central Hardware Co. v. NLRB, 407 U.S. 539 (1972) 16
Chicago v. Environmental Defense Fund, 511 U.S. 328 (1994) 9, 14
City of Detroit v. Murray Corp., 355 U.S. 489 (1958) 16
Dewsnup v. Timm, 502 U.S. 410 (1992) 14
Doneski v. Comptroller of the Treasury, 605 A.2d 649 (Md. Ct.Spec. App. 1992), *cert. denied*, 506 U.S. 1054 (1993) 20
Duren v. Missouri, 439 U.S. 357 (1979) 16
FTC v. Texaco, Inc., 393 U.S. 223 (1968) 16
Field v. Mans, 116 S. Ct. 437 (1995) 14
Fulton Corp. v. Faulkner, 116 S. Ct. 848 (1996) 20
Gozlon-Peretz v. United States, 498 U.S. 395 (1991) 14
Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64 (1963) 19
Hardin v. Straub, 490 U.S. 536 (1989) 16
Harte-Hanks Communications, Inc. v. Connaughton, 491 U.S. 657 (1989) 16
Home Savings Bank v. City of Des Moines, 205 U.S. 503 (1907) 15
Honda Motor Co. v. Oberg, 512 U.S. 415 (1994) 16
Kentucky v. Whorton, 441 U.S. 786 (1979) (per curiam) . . 16
Kuhlmann v. Wilson, 477 U.S. 436 (1986) 16
MCI Telecommunications Corp. v. Limbach, 625 N.E.2d 597 (Ohio), *cert. denied*, 513 U.S. 818 (1994) 7
Memphis Bank & Trust Co. v. Garner, 459 U.S. 392 (1983) . . . . . *passim*

TABLE OF AUTHORITIES
(Continued)

Page

Michigan v. Clifford, 464 U.S. 287 (1984) 16
Nebraska Department of Revenue v. Loewenstein, 513 U.S. 123 (1994) 8, 11, 12
Oregon Waste Systems, Inc. v. Department of Environmental Quality, 511 U.S. 93 (1994) 19
Rockford Life Insurance Co. v. Illinois Department of Revenue, 482 U.S. 182 (1987) 9, 17
Society for Savings v. Bowers, 349 U.S. 143 (1955) 13
United States v. City of Detroit, 355 U.S. 466 (1958) 16
United States v. County of Fresno, 429 U.S. 452 (1977) 9, 17, 18
United States v. Powell, 469 U.S. 57 (1984) 16
United States v. Township of Muskegon, 355 U.S. 484 (1958) 16
Werner Machine Co. v. Director of Division of Taxation, 350 U.S. 492 (1956) 17
Willcuts v. Bunn, 282 U.S. 216 (1931) 17

Constitutional Provisions and Statutes

U.S. Const., art. VI, § 2 1
28 U.S.C. § 1257 1
31 U.S.C. § 3124 . . . . . *passim*
Conn. Gen. Stat. § 12-701(a)(20) 21
Kan. Stat. Ann. § 32-862 21
Kan. Stat. Ann. § 68-2013 21
Kan. Stat. Ann. § 68-2041 21
Ohio Rev. Code Ann. § 5709.76 . . . . . 3, 5
Ohio Rev. Code Ann. § 5733.04(I) . . . . . *passim*
Ohio Rev. Code Ann. § 5733.06 4
Act of June 25, 1947, ch. 147, 61 Stat. 180 15
Act of Sept. 24, 1917, ch. 56, § 7, 40 Stat. 288, 291 15
Act of Feb. 25, 1862, ch. 33, 12 Stat. 345 (codified at 31 U.S.C. § 742) (revised) 13
Pub. L. No. 86-346, § 105, 73 Stat. 621, 622 14

TABLE OF AUTHORITIES
(Continued)

Page

Pub. L. No. 97-258, § 3124, 96 Stat. 877, 945 15
Public Debt Act of 1941, ch. 7, § 4, 55 Stat. 7, 9
(codified at 31 U.S.C. § 742a) (revised) 15

Miscellanous Authorities
Black's Law Distionary (6th ed. 1990) 12
H.R. Rep. No. 423, 8th Cong., 1st Sess.,
reprinted in 1947 U.S.C.C.A.N. 1218 15
Pennsylvania Dept. of Revenue Tax Update
No. 16 (July 1, 1987) 21
S. Rep. No. 275, 80th Cong. 1st Sess,
reprinted in 1947 U.S.C.C.A.N. 1217 15

PETITION FOR A WRIT OF CERTIORARI

NACCO Industries, Inc. ("NACCO") respectfully petitions for a writ of certiorari to review the judgment of the Supreme Court of Ohio in this case.

OPINIONS BELOW

The opinion of the Supreme Court of Ohio is reported at 681 N.E.2d 900. It is reprinted at pages 1a-11a of the appendix to this petition. The decision and order of the Ohio Board of Tax Appeals is unreported. It is reprinted at pages 12a-20a of the appendix to this petition.

JURISDICTION

The judgment of the Supreme Court of Ohio was entered on August 6, 1997. On October 23, 1997, Justice Stevens extended the time for filing a petition of certiorari to and including November 24, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Supremacy Clause of Article VI, section 2 to the United States Constitution provides:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Section 3124 of Title 31, United States Code, provides:

> (a) Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except — (1) a nondiscriminatory franchise tax or another nonproperty tax

instead of a franchise tax, imposed on a corporation; and (2) an estate or inheritance tax.

(b) The tax status of interest on obligations and dividends, earnings, or other income from evidences of ownership issued by the Government or an agency and the tax treatment of gain and loss from the disposition of those obligations and evidences of ownership is decided under the Internal Revenue Code of 1954 (26 U.S.C. 1 et seq.). An obligation that the Federal Housing Administration had agreed, under a contract made before March 1, 1941, to issue at a future date, has the tax exemption privileges provided by the authorizing law at the time of the contract. This subsection does not apply to obligations and evidences of ownership issued by the District of Columbia, a territory or possession of the United States, or a department, agency, instrumentality, or political subdivision of the District, territory, or possession.

Section 5733.04(I) of the Ohio Revised Code provides, in pertinent part:

(I) "Net income" means the taxpayer's taxable income before operating loss deduction and special deductions, as required to be reported for the taxpayer's taxable year under the Internal Revenue Code, subject to the following adjustments:

* * *

(5) Deduct any interest or interest equivalent on public obligations and purchase obligations to the extent included in federal taxable income. As used in divisions (I)(5) and (6) of this section, "public obligations," "purchase obligations," and "interest or interest equivalent" have the same meanings as in section 5709.76 of the Revised Code.

(6) Add any loss or deduct any gain resulting from the sale, exchange, or other disposition of public obligations to the extent included in federal taxable income.

Section 5709.76 of the Ohio Revised Code provides, in pertinent part:

(A) All of the following are exempt from taxes levied by the state and its subdivisions:

(1) Public obligations;

(2) Interest or interest equivalent on public obligations and on purchase obligations;

(3) The transfer, and any profit made on the sale, exchange, or other disposition, of public obligations.

* * *

(D) As used in this section:

* * *

(5) "Public obligations" means public securities, fractionalized interests in purchase obligations, and any obligation or evidence of obligation to pay interest or interest equivalent on public securities or on fractionalized interests in purchase obligations, and does not include purchase obligations.

(6) "Public securities" means bonds, notes, certificates of indebtedness, commercial paper, and other instruments in writing issued by the state or a subdivision, or by any nonprofit corporation authorized to issue public securities for or on behalf of the state or a subdivision, to evidence the obligation of the state, subdivision, or nonprofit corporation to repay money borrowed by, or to pay at any future time other money obligations of, the state, subdivision, or nonprofit corporation, and does not include purchase obligations. Public securities may be in the form of either certificated securities or uncertificated securities, as those terms are defined in section 1308.01 of the Revised Code.

STATEMENT

This case presents important questions regarding the limitations upon discriminatory state taxation imposed both by 31 U.S.C. § 3124(a) and by the intergovernmental tax immunity doctrine of the Constitution's Supremacy Clause.

NACCO's Activities. On September 27, 1982, for investment purposes, NACCO purchased for $6,100,003 a fifteen-year U.S. Treasury Bond with a principal amount of $8,000,000. App. 12a. On May 5, 1989, NACCO sold this bond for $7,694,071. NACCO realized a $1,467,493 long-term capital gain from the sale of this bond; the remaining $126,575 represented accrued but unpaid interest. App. 1a. Because Ohio's franchise tax excludes consideration of gain from the sale of Ohio-issued obligations, it was NACCO's belief, in view of the applicable federal statutory and constitutional restrictions, that the capital gain from the sale of this federal obligation could likewise not be considered in the calculation of the franchise tax. Accordingly, NACCO did not include the $1,467,493 gain as part of its net income in calculating its 1990 Ohio franchise tax return, and it "flagged this issue in a separate statement" submitted with the return. *See* Transcript of Hearing Before the Ohio Board of Tax Appeals ("Tr.") at 12-14; App. 12a.

The Ohio Franchise Tax. Under Ohio law, the initial base for calculating a corporation's net income is its federal taxable income before any operating loss or special deductions. *See* Ohio Rev. Code Ann. § 5733.04(I).[1] In calculating net income, gains from the sale of federal obligations are included in income, while gains from the sale of state obligations are not. This result occurs because corporations may "[a]dd any loss or deduct any gain resulting from the sale, exchange, or other disposition of public obligations to the extent included in federal taxable income."

---

[1] The State of Ohio requires corporations to calculate their franchise tax on both a net worth and a net income basis, and to pay the greater amount. *See* Ohio Rev. Code Ann. § 5733.06. Here, the net income calculations yielded the greater tax liability.

Ohio Rev. Code Ann. § 5733.04(I)(6). A "public obligation" under this provision is defined to include "public securities," *see* Ohio Rev. Code Ann. §§ 5733.04(I)(5), 5709.76(D)(5); in turn, the definition of "public securities" includes "bonds, notes, certificates of indebtedness, commercial paper, and other instruments in writing *issued by the state or a subdivision*." Ohio Rev. Code Ann. § 5709.76(D)(6) (emphasis added). However, the definition of "public securities" does not include obligations issued by the federal government.

The Tax Commissioner's Assessment. When NACCO filed its 1990 Ohio Corporate Franchise Tax Report, it excluded from its tax base, as determined by the net income method, the $1,467,493 gain NACCO realized from the sale of its treasury bond. App. 12a; Tr. 12-13. On October 14, 1993, the Ohio Department of Taxation issued a franchise-tax assessment to NACCO for the 1990 tax year in the amount of $116,202.58, plus $37,343 in interest. The Department of Taxation concluded that the gain realized by NACCO from the sale of its U.S. Treasury Bond should have been included in NACCO's 1990 Ohio franchise tax base under the net income method. App. 12a-13a.

On November 12, 1993, NACCO filed a Petition for Reassessment, objecting to the franchise-tax assessment on the ground that inclusion of the gain from the sale of the U.S. Treasury Bond in calculating its Ohio franchise tax base violated the United States Constitution because (1) it impermissibly discriminated against federal obligations by excluding similar gains from the sale of obligations issued by the State of Ohio from the franchise tax, and (2) it violated 31 U.S.C. § 3124(a) since the state statute required the "obligation . . . to be considered in computing the tax."[2] App. 13a. The Tax

---

[2] Section 3124(a) of Title 31, United States Code, provides in pertinent part:

> Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The

Commissioner, however, rejected NACCO's arguments and issued his final determination on September 28, 1995, affirming the Department of Taxation's assessment.

Proceedings Before The Board of Tax Appeals. NACCO appealed from the Tax Commissioner's determination to the Ohio Board of Tax Appeals ("BTA") on October 27, 1995. The state did not dispute that the statute taxed the gain from the sale of federal obligations while exempting gain from the sale of state obligations. During a March 26, 1996, hearing before a BTA hearing examiner, NACCO presented unrebutted testimony from an expert financial witness from the Ohio State University, Stephen A. Buser, who testified that if gain from the sale of federal, but not state, obligations was taxable by the state, the federal government "would have to increase the interest rate" on new bonds "to compensate for the negative tax consequence"; existing bonds, similarly, "would be placed at a disadvantage." Tr. 25-26. Buser testified that because "[i]t is generally accepted that securities all compete for roughly the same set of investment dollars," any attribute that makes a particular security "becom[e] incrementally less attractive" would either cause "that security [to] drop out of the investment opportunity set," or the issuing agency would have to compensate for that burden in some other way "to make investors still want to hold those securities." Tr. 26-27.

On June 7, 1996, the BTA affirmed the Tax Commissioner's final determination. App. 12a-20a. Because the only issues presented on appeal to the BTA were constitutional ones (preemption under 31 U.S.C. § 3124, and intergovernmental tax immunity under the Supremacy Clause), the BTA's affirmance was largely *pro forma* — Ohio law provides that the BTA acts as a "receiver of evidence," but "cannot rule on" constitutional

---

exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except — (1) a nondiscriminatory franchise tax. . . .

questions; the latter task is left solely to the Ohio Supreme Court. *MCI Telecommunications Corp. v. Limbach*, 625 N.E.2d 597, 599 (Ohio), *cert. denied*, 513 U.S. 818 (1994). Accordingly, the BTA held that it was "beyond the jurisdiction of the Board of Tax Appeals" to decide the two constitutional questions presented by NACCO's appeal, and it affirmed the Tax Commissioner's final determination. App. 20a.

Proceedings Before The Ohio Supreme Court. In accordance with Ohio practice, NACCO appealed the BTA's ruling to the Ohio Supreme Court. NACCO reurged its twin arguments that Ohio's taxation of gains realized from the sale of its U.S. Treasury Bond — but not from the sale of similar state obligations — was prohibited both under 31 U.S.C. § 3124 and by the United States Constitution under the intergovernmental tax immunity doctrine. App. 2a.

The Tax Commissioner opposed both arguments. Again, the differential treatment of gain from state and federal obligations was admitted. With respect to section 3124, the Commissioner urged that the Ohio franchise tax's consideration of "gains realized from the sale of federal obligations" does not fall within section 3124(a)'s prohibition upon "each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax." Comm'rs Br. at 8-14. Significantly, however, the Commissioner did not argue that, if the Ohio tax scheme were covered by section 3124(a), the Ohio franchise tax would fall within the statutory exception for "a nondiscriminatory franchise tax . . . imposed on a corporation." 31 U.S.C. § 3124(a)(1).

With respect to NACCO's intergovernmental tax immunity argument, the Commissioner urged that NACCO was erroneously "focus[ing] on only part of the provision that it attacks" (*i.e.*, the admittedly differential treatment of federal and state obligations). Comm'rs Br. at 15. Instead, the Commissioner urged, NACCO was required to "consider the whole statute," including the provision that requires the add-back of losses from the sale of state obligations but not federal obligations (Ohio Rev.

Code Ann. § 5733.04(I)(6)). Comm'rs Br. at 15-17. According to the Commissioner, NACCO's intergovernmental tax immunity argument suffered from a failure of proof because NACCO's expert witness could not express an opinion as to whether the overall "economic effect of the statutory scheme . . . would be a positive or a negative one as to the marketability of federal obligations." *Id.* at 16.

The Ohio Supreme Court's Decision. The Ohio Supreme Court affirmed the decision of the Board of Tax Appeals, recognizing the differential treatment and adopting much the same reasoning advanced by the Commissioner.

The court first held that 31 U.S.C. § 3124 did not prohibit the application of Ohio's franchise tax to the gain from NACCO's sale of the U.S. Treasury Bond. It concluded, despite the statutory language, that section 3124(a), "[b]y its terms . . . does not extend to gains from the sale of federal obligations." App. 4a. The Ohio court viewed its construction of the statute as compelled by this Court's decision in *Nebraska Department of Revenue v. Loewenstein*, 513 U.S. 123 (1994). *Loewenstein* involved private "repurchase agreements" — two-step loan transactions in which security holders temporarily transfer their federal securities to a trust in exchange for a cash loan, which is later paid back to the trust (with interest on the loan) in exchange for a return of the securities. This Court held that the interest received was interest on loans of cash, not interest on "obligations of the United States Government." *Id.* at 129. According to the Ohio Supreme Court, NACCO's gain was similar to the non-exempt interest in *Loewenstein* — it was "attributable to a contractual relationship between two private parties," and "not attributable to redemption of the obligations or payment by the United States government." App. 5a.

The Ohio Supreme Court also viewed its construction of the statute as compelled by canons of statutory construction, relying on differences in language between the statute involved here (31 U.S.C. § 3124(a)), and 31 U.S.C. § 3124(b), the Public Debt Act of 1941, which provides for *federal* taxation of United States

government obligations. The court reasoned that section 3124(b), unlike section 3124(a), "incorporates the phrase 'tax treatment of gain and loss from the disposition of these [federal] obligations.' Congress is generally presumed to act intentionally and purposely when it includes particular language in one section of a statute but omits it in another." App. 4a (citing *Chicago v. Environmental Defense Fund,* 511 U.S. 328, 338 (1994)). Like the Commissioner, the Ohio Supreme Court did not even advert to section 3124(a)(1)'s exception for "a nondiscriminatory franchise tax . . . imposed on a corporation."

The court also rejected NACCO's intergovernmental tax immunity argument. The court held that Ohio's imposition of tax on gain from federal obligations is "'far too attenuated' from the doctrine's concern with the borrowing power of the United States to support constitutional immunity." App. 6a-7a (quoting *Rockford Life Ins. Co. v. Illinois Dep't of Revenue,* 482 U.S. 182, 190 (1987)). Addressing NACCO's argument that the tax was invalid under the antidiscrimination component of the intergovernmental tax immunity doctrine, the Ohio court adverted to the holding of *United States v. County of Fresno,* 429 U.S. 452, 460 (1977), that "[s]o long as the tax is not directly laid on the Federal Government, it is valid if nondiscriminatory . . . or until Congress declares otherwise" (App. 4a (quotation omitted)), and concluded that Congress had somehow "declared otherwise" in section 3124(a) — even though that section on its face gives no approval to discriminatory taxation. Thus, the court held that "Ohio's franchise tax is valid, regardless of whether it is discriminatory." App. 9a.

Finally, even though the court stated that it did not need to consider whether the Ohio franchise tax discriminated against the federal government, the court nonetheless concluded that NACCO had failed to prove discrimination. Citing no authority, the Ohio court held that NACCO, to prevail, had to show as a factual matter that, taking *all* provisions of the Ohio franchise tax into account, "any difference in treatment between state and federal obligations affects or impedes a function of the federal government; in this case, the marketability of federal obligations."

App. 10a. Even though NACCO's expert witness had concluded that deducting gains from the sale of Ohio public obligations but not federal obligations "would place federal obligations at a disadvantage in the market" (App. 10a), the court held this evidence to be insufficient as a matter of law to demonstrate discrimination. The court relied on the fact that Ohio also required corporations to add back losses from the sale of state obligations, and that the same was not true of losses from federal obligations. Since NACCO's expert could not express an opinion about the relative marketability of federal obligations when both the deduction of gains and the addition of losses from the sale of state obligations but not federal obligations are taken into account, the court concluded that "NACCO has failed to establish that the franchise tax discriminates against the federal government or those with whom it deals." App. 11a.

REASONS FOR GRANTING THE WRIT

This case raises important questions concerning the federal statutory and constitutional limitations upon state taxation of federal obligations.

I. IN HOLDING THAT THE OHIO TAX DID NOT VIOLATE 31 U.S.C. § 3124, THE OHIO SUPREME COURT MISINTERPRETED THIS COURT'S DECISION IN *NEBRASKA DEPARTMENT OF REVENUE v. LOEWENSTEIN*

Section 3124(a) of Title 31, United States Code, provides in part:

> Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except — (1) a nondiscriminatory franchise tax . . . .

This Court has held that this statute "establishes a broad exemption of federal obligations from state and local taxation,"

Memphis Bank & Trust Co. v. Garner, 459 U.S. 392, 395 (1983), a "sweeping" exemption that extends to "*every form*" of state taxation where "federal obligations must be considered, either directly or indirectly, in *computing* the tax." *American Bank & Trust Co. v. Dallas County*, 463 U.S. 855, 862 (1983) (emphasis in original). The Ohio Supreme Court nonetheless held that Ohio's franchise tax, which taxes gains from the sale of federal but not state obligations, did not violate section 3124(a).[3] The court reached this conclusion based upon a misreading of this Court's decision in *Nebraska Department of Revenue v. Loewenstein*, 513 U.S. 123 (1994), and by a fundamental misapplication of statutory construction principles at odds with this Court's teachings. Certiorari should be granted to resolve these conflicts.

There was no contention in *Loewenstein* that the state tax at issue impermissibly "require[d] the obligation . . . to be considered in computing the tax," and the Court's approval of the Nebraska tax cannot possibly be read as approving state taxation of gains from the sale of federal obligations. The sole question presented to this Court in *Loewenstein* was whether interest earned by a taxpayer from repurchase agreements ("repos") involving federal securities was immune from state tax under section 3124(a) as "interest on" an "[o]bligatio[n] of the United States Government." "Repos" are two-step loan transactions in which the holder of a federal obligation transfers the obligation to a trust, which then makes a cash loan to the holder. Under the repo agreement, the holder later pays back the loan to the trust, with an agreed-upon rate of interest not tied to the interest rate on

---

[3] The Ohio Supreme Court did not hold, and respondent has never argued, that Ohio's franchise tax on corporations is "a nondiscriminatory franchise tax . . . imposed on a corporation" sufficient to satisfy one of the two express exceptions to 31 U.S.C. § 3124(a). Nor could it be seriously maintained that the franchise tax is "nondiscriminatory" in view of the patently discriminatory treatment of gains from federal obligations *vis-a-vis* state obligations. See discussion at pages 16-20, below.

the federal obligation, in exchange for the return of the obligation. This Court held that the "interest" earned by the taxpayer from his transaction with the trust was not tax-exempt "interest on the obligation," 31 U.S.C. § 3124(a), but instead was taxable "interest on loans of cash from the Trusts to the Seller-Borrower." *Loewenstein,* 513 U.S. at 129.

Unlike *Loewenstein,* this case does not present the question of whether gain on the sale of a federal obligation is "interest on the obligation." The court below plainly misunderstood *Loewenstein* when it held that because "the income at issue here is not attributable to redemption of the obligations or payment by the United States government," but was "attributable to a contractual relationship between two private parties," the gain realized by NACCO from its sale of the treasury bond was permissibly taxed under 31 U.S.C. § 3124(a). App. 5a. *Loewenstein* does not rest on the ground that section 3124(a) applies only to income from United States government redemptions or interest payments, and the statutory language could not possibly support such a reading.

Section 3124(a) prohibits taxation of gains from the sale of federal securities, because taxation of such gains "require[s] the obligation . . . to be considered in computing a tax." 31 U.S.C. § 3124(a). This provision prohibits not only tax on the "redemption of the obligations or payment by the United States government" (App. 5a), but prohibits *all* taxes that take the *value* of the obligation into account, whether directly or indirectly. As *Loewenstein* itself explained, "[b]y contrast" to the treatment of interest under section 3124(a), "[t]he obligation itself is 'considered' *when its value is 'taken into account, or included in the accounting,'* in computing the taxable value of a taxpayer's assets or net worth for the purpose of a property tax or the like." 513 U.S. at 128-29 (emphasis added; quoting *American Bank & Trust Co. v. Dallas County,* 463 U.S. at 862). The Ohio tax on the "gain" recognized on the sale of the obligation thus obviously "take[s] into account" the "*value*" of the obligation — indeed, the dictionary definition of "gain" is "[a]ppreciation in *value* or worth *of securities* or property." *Black's Law Dictionary* 678 (6th ed. 1990) (emphasis added).

The Ohio court's refusal to give effect to the plain language of section 3124(a), coupled with its misreading of this Court's *Loewenstein* decision, resulted in a highly formalistic construction of section 3124(a). Such formalism is contrary both to the statute's "broad exemption" (*Memphis Bank & Trust Co. v. Garner*, 459 U.S. at 395), and to congressional intent. As this Court recognized in *American Bank & Trust Co. v. Dallas County*, section 3124(a) (then known as Rev. Stat. § 3701, or 31 U.S.C. § 742) was amended in 1959 to overturn "this Court's rather formalistic pre-1959 approach to § 3701," under which the Court had "consistently held" that "§ 3701 did not prohibit nondiscriminatory taxes imposed on discrete property interests such as corporate shares *or business franchises*, even though the value of that discrete interest was measured by the underlying assets." 463 U.S. at 858 (emphasis added). Up to 1959, "this formal but economically meaningless distinction between taxes on Government obligations and taxes on separate interests was 'firmly embedded in the law.'" *Id.* (quoting *Society for Savings v. Bowers*, 349 U.S. 143, 148 (1955)).[4]

To counter the highly formalistic interpretation announced by this Court, Congress in 1959 added a sweeping sentence to the statute — "'[t]his exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax.'" *Id.* (quoting statute) (Current section 3124(a) contains almost identical language.) This Court has subsequently recognized that "[u]nder the plain language of the 1959 amendment, . . . the tax is barred regardless of its *form* if federal obligations must be considered, either directly or indirectly, in *computing* the tax." 463 U.S. at 862 (emphasis in original). Thus, by enacting section 3124(a) "Congress intended

---

[4] Prior to 1959, Rev. Stat. § 3701, 31 U.S.C § 742, provided, in pertinent part, that "[a]ll stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority." *See American Bank & Trust Co. v. Dallas County*, 463 U.S. 855, 858 (1983).

to sweep away formal distinctions and to invalidate all taxes measured directly or indirectly by the value of federal obligations." *Id.* at 867. The Ohio Supreme Court's decision, however, impermissibly resurrects the pre-1959 formalism.

The court below exacerbated its erroneous reading of section 3124(a) and *Loewenstein* by an untenable application of statutory construction principles. The court held that because section 3124's *other* subsection, 31 U.S.C. § 3124(b), "incorporates the phrase 'tax treatment of gain and loss from the disposition of those [federal] obligations,'" the logical inference is that Congress meant to exclude "gains from the sale of federal obligations" from the exemption provision of section 3124(a). App. 4a-5a (citing *Chicago v. Environmental Defense Fund,* 511 U.S. 328, 338 (1994)). Such a "negative pregnant" construction of section 3124(a) (*Field v. Mans,* 116 S. Ct. 437, 442 (1995)) has no application where, as here, the two subsections of section 3124 have their origins in two entirely different congressional enactments, and do not possess parallel structure in any event. *See id.* at 446; *see also Gozlon-Peretz v. United States,* 498 U.S. 395, 404 (1991).[5]

The history of the two subsections of section 3124 illustrates this. Section 3124(a) was originally enacted by Congress during the Civil War, Act of Feb. 25, 1862, ch. 33, 12 Stat. 345, codified in 1925 as 31 U.S.C. § 742, amended in 1959 (Pub. L. No. 86-346, § 105, 73 Stat. 621, 622) to "rejec[t] and set aside this Court's rather formalistic pre-1959 approach" (*American Bank & Trust v. Dallas County,* 463 U.S. at 862), and ultimately codified as 31 U.S.C. § 3124(a) in 1982 without substantial change. Prior to the Civil War, it had not been deemed necessary to enact legislation expressly stating that state governments were

---

[5] Even where a statute contains the identical term in different subsections (which is not the case here) the term may carry two different meanings — particularly where history and prior practice indicate that the sections should have different meanings. *Dewsnup v. Timm,* 502 U.S. 410, 417-20 (1992).

prohibited by the Constitution from taxing federal securities; the political climate of Civil War times, however, made it necessary for the Congress to do so. *Home Savings Bank v. City of Des Moines*, 205 U.S. 503, 513-14 (1907).

By contrast, section 3124(b) has an entirely different history. Its origins are in the Public Debt Act of 1941, 55 Stat. 7, then codified as 31 U.S.C. § 742a, which was passed to remove the *federal* tax exemption for federal securities, an exemption that originally had been granted in 1917 in order to fund World War I. *See* Act of September 24, 1917, ch. 56, § 7, 40 Stat. 288, 291 ("All such bonds and certificates shall be exempt, both as to principal and interest from all taxation now or hereafter imposed by the United States, any state, or any of the possessions of the United States, or by any local taxing authority . . . .").[6]

The two statutes were joined together by Congress when they were recodified as separate subsections of 31 U.S.C. § 3124 in 1982. *See* Pub. L. No. 97-258, § 3124, 96 Stat. 877, 945. In view of the divergent histories of subsections 3124(a) and 3124(b), and the resultant lack of a parallel structure between those subsections, the "negative pregnant" canon of statutory construction had no place here.

In sum: Certiorari should be granted to correct the Ohio Supreme Court's fundamental misinterpretation of 31 U.S.C.

---

[6] The legislative history of then-section 742a made quite clear that the Act "*makes no change* in existing law with respect to the taxation of Federal securities by the States and their political subdivisions . . . ." S. Rep. No. 275, 77th Cong., 1st Sess., *reprinted in* 1947 U.S.C.C.A.N. 1217 (emphasis added). A 1947 adjustment to the text of then-section 742a (Act of June 25, 1947, ch. 147, 61 Stat. 180) caused the House Committee on Ways and Means to reiterate that the passage of section 742a "indicates no intent to permit taxation of Federal securities by other jurisdictions than the Federal government." H.R. Rep. No. 423, 80th Cong., 1st Sess., *reprinted in* 1947 U.S.C.C.A.N. 1218.

§ 3124(a), and of this Court's prior decision in *Nebraska Department of Revenue v. Loewenstein*.[7]

II. CERTIORARI SHOULD BE GRANTED BECAUSE THE OHIO SUPREME COURT'S DECISION CONFLICTS WITH THIS COURT'S DECISION IN *MEMPHIS BANK & TRUST CO. v. GARNER*

The Ohio Supreme Court's constitutional decision also conflicts with this Court's decision in *Memphis Bank & Trust Co. v. Garner, supra*.

The doctrine of intergovernmental tax immunity, as interpreted by this Court, comprises two separate and distinct components. The first component, which is not at issue here, provides an absolute immunity from state taxation, but is limited to taxes imposed "directly against the Government of the United States or its property without the consent of Congress." *United States v. City of Detroit*, 355 U.S. 466, 469 (1958). *See also City of Detroit v. Murray Corp.*, 355 U.S. 489 (1958); *United States v. Township of Muskegon*, 355 U.S. 484 (1958).

The second component, which might be called the "antidiscrimination component" of the doctrine, forbids state taxes that "impos[e] a greater burden on holders of federal property than on holders of similar state property." *Memphis Bank & Trust Co. v.*

---

[7] This Court has often granted certiorari to address the question of whether the lower courts have consistently and correctly applied a prior decision of this Court. *See, e.g., Honda Motor Co. v. Oberg*, 512 U.S. 415, 420 (1994); *Barker v. Kansas*, 503 U.S. 594, 597 (1992); *Harte-Hanks Communications, Inc. v. Connaughton*, 491 U.S. 657, 659 (1989); *Hardin v. Straub*, 490 U.S. 536, 536 (1989); *Kuhlmann v. Wilson*, 477 U.S. 436, 444 (1986); *United States v. Powell*, 469 U.S. 57, 61-62 (1984); *Michigan v. Clifford*, 464 U.S. 287, 289 (1984); *Kentucky v. Whorton*, 441 U.S. 786, 787 (1979) (per curiam); *Duren v. Missouri*, 439 U.S. 357, 363 (1979); *Central Hardware Co. v. NLRB*, 407 U.S. 539, 542 (1972); *FTC v. Texaco, Inc.*, 393 U.S. 223, 225 (1968); *Brotherhood of Railway and Steamship Clerks, Freight Handlers, Express and Station Employees v. Allen*, 373 U.S. 113, 118 (1963).

Garner, 459 U.S. at 397. *See also United States v. County of Fresno*, 429 U.S. at 462 ("a state tax imposed on those who deal with the Federal Government" is unconstitutional if the tax "is imposed [un]-equally on . . . similarly situated constituents of the State"). Only where the "tax remains the same whatever the character of the [property] may be" can such a state tax be upheld. *Werner Machine Co. v. Director of Division of Taxation*, 350 U.S. 492, 493-94 (1956); *see also Memphis Bank & Trust Co. v. Garner*, 459 U.S. at 397-98. Thus, the antidiscrimination component prohibits all state taxes that discriminate "against holders of federal property or those with whom the Federal Government deals." *Id.* at 397. The principal cases relied upon by the Ohio Supreme Court were inapposite to the discrimination issue — they involved the first, narrower component of the doctrine, not the antidiscrimination component.[8]

This Court recognized and applied this antidiscrimination principle in *Memphis Bank & Trust Co. v. Garner*, *supra*. Tennessee's bank tax imposed a tax on the "net earnings" of banks doing business in the state, and "include[d] income from obligations of the United States and its instrumentalities" — but not income from Tennessee obligations — in the tax base. 459 U.S. at 393. The Court held that this discriminatory tax scheme violated the antidiscrimination component of the intergovernmental tax immunity doctrine: "Tennessee discriminates in favor of securities issued by Tennessee and its political subdivisions and against federal obligations. The State does so by including in the tax base income from otherwise comparable state and local obligations." *Id.* at 398. The Court thus concluded that the Tennessee tax was unconstitutionally discriminatory. *Id.* at 398-99.

---

[8] *See* App. 6a-8a (citing *Rockford Life Insurance Co. v. Illinois Dep't of Revenue*, 482 U.S. 182 (1987) (upholding nondiscriminatory tax on "Ginnie Mae" bonds issued by private financial institutions), and *Willcuts v. Bunn*, 282 U.S. 216 (1931) (upholding nondiscriminatory federal tax on gains from sale of state and municipal obligations)).

The Ohio Supreme Court plainly misunderstood the antidiscrimination principle. Citing *Memphis Bank & Trust Co. v. Garner,* the court misquoted that case by holding that "a state tax is invalid only if it discriminates against the federal government or those with whom it deals." App. 11a (citing *Memphis Bank & Trust Co. v. Garner,* 459 U.S. at 397). What the cited page of *Memphis Bank & Trust Co. v. Garner* actually says, of course, is that taxes which "discriminate against *holders of federal property* or those with whom the Federal Government deals" are invalid. 459 U.S. at 397 (emphasis added). NACCO was plainly a "holde[r] of federal property," and was plainly discriminated against by Ohio's taxation of its gains from the sale of its federal obligation.

Despite its recognition that the Ohio franchise tax distinguishes between holders of state and federal property (*see, e.g.,* App. 2a ("gain from the sale of an Ohio obligation is exempt from the Ohio franchise tax, while gain from the sale of a federal obligation is not") (footnote omitted)), the Ohio Supreme Court nonetheless held that "Ohio's franchise tax is valid, regardless of whether it is discriminatory." App. 9a. The court reached this conclusion by relying on the rule that a discriminatory tax such as Ohio's franchise tax, even though "not directly laid on the Federal Government," violates the Supremacy Clause unless "Congress declares otherwise." *United States v. County of Fresno,* 429 U.S. at 460 (citation omitted); App. 4a. The court determined that "Congress has 'declared otherwise,'" by impliedly excluding gains from the sale of federal obligations from the scope of 31 U.S.C. § 3124(a)'s immunity. App. 4a. This conclusion was untenable as a matter of statutory construction since section 3124(a) does not remotely indicate congressional approval of discriminatory state franchise taxes. Indeed, as discussed above, Congress specifically *disapproved* of such discriminatory taxes. *See* 31 U.S.C. § 3124(a)(1).

In an attempt to buttress its holding that the discriminatory franchise tax was nonetheless constitutional, the Ohio court held alternatively that NACCO was guilty of a failure of proof. The supreme court held, citing no authority in support, that NACCO

was not only required to prove discrimination; it was also required to "demonstrate that any difference in treatment between state and federal obligations affects or impedes a function of the federal government; in this case, the marketability of federal obligations." App. 9a-10a. No such proof was required. *See, e.g., Memphis Bank & Trust Co. v. Garner,* 459 U.S. at 398 & n.8 (finding unconstitutional discrimination on the face of the statute without resort to expert testimony). In any event, NACCO's expert witness testified that the taxation of gains from federal but not state obligations would place federal obligations at a market disadvantage, and would require the federal government to raise its coupon rate to compensate for the disadvantage. *See* Tr. 26-27. The Ohio court found this testimony insufficient to satisfy the test it had just announced. Instead, the Ohio court said, NACCO's case failed because its expert witness could not express an opinion as to the relative marketability of federal obligations when the *deductibility of losses* from federal but not state obligations was also factored into the overall equation. App. 10a.

The court in effect found that the provision allowing add-back of *losses* from the sale of federal obligations, Ohio Rev. Code § 5733.04(I)(6), was sufficiently "compensatory" for the admittedly discriminatory treatment of *gains* from the sale of federal obligations. No such "compensatory tax" doctrine exists in the intergovernmental immunity area; indeed, none has ever been recognized outside the sales and use tax area. *Oregon Waste Systems, Inc. v. Department of Environmental Quality,* 511 U.S. 93, 105 (1994). But even if a compensatory tax doctrine could be engrafted onto the doctrine of intergovernmental tax immunity, the Ohio Supreme Court's version could not be sustained. This Court has always demanded "strict equality" from "compensatory" taxes (*see, e.g., Halliburton Oil Well Cementing Co. v. Reily,* 373 U.S. 64, 73 (1963)); the Ohio tax fails that requirement. This Court has repeatedly expressed its "unwilling[ness] to plunge . . . into the morass of weighing comparative tax burdens," recognizing that "[t]he complexities of factual economic proof always present a certain potential for error, and courts have

little familiarity with the process of evaluating the relative economic burden of taxes" (*Fulton Corp. v. Faulkner*, 116 S. Ct. 848, 859 (1996) (quotation omitted)); the complex economic testimony required by the Ohio court's newly minted test was likewise contrary to this authority.

At least one other state court has reached a decision contrary to that of the court below. In *Doneski v. Comptroller of the Treasury*, 605 A.2d 649 (Md. Ct. Spec. App. 1992), *cert. denied*, 506 U.S. 1054 (1993), the court held that Maryland's taxation of gains from the sale of federal obligations, while exempting comparable gains from the sale of bonds issued by the State of Maryland, was prohibited both by 31 U.S.C. § 3124(a) and by the intergovernmental tax immunity doctrine. The Maryland court recognized that the underlying purpose of this provision was to prohibit the imposition of state taxes that disadvantage federal obligations in the marketplace. 605 A.2d at 653-54. It found that Maryland's tax scheme "clearly discriminate[d] against the federal government and the people with whom it deals" by "diminishing the investment attractiveness of the United States obligations in favor of state obligations." *Id.* at 654.

In sum: Certiorari should be granted to resolve the conflict between the decision below and this Court's decision in *Memphis Bank & Trust Co. v. Garner*.

III. THE ISSUES PRESENTED BY THIS CASE ARE IMPORTANT

The issues raised by this case have serious implications for the ability of the federal government to borrow money through the issuance of federal obligations. If taxpayers were unable to deduct gains from the sale of federal and state obligations equally, federal obligations would be placed at a distinct disadvantage in the market and rendered less attractive to the investing public. *See Memphis Bank & Trust Co. v. Garner*, 459 U.S. at 398 n.8 (citing data provided by the brief *amicus curiae* of the United States). If Ohio's rule were adopted by other states, the federal government would have to offer a higher interest rate on its securities — ultimately increasing the federal government's cost

of borrowing money — in order to compensate for the market disadvantage imposed on federal obligations by the discriminatory franchise tax. *See, e.g., id.* (noting that "if all 50 States enacted provisions comparable to the Tennessee bank tax, the United States would incur additional borrowing costs estimated at $280 million at an interest rate of 12%").

Even at present, this problem is not limited to Ohio. A number of other states also exempt gains from the sale of state — but not federal — obligations from taxation. For instance, the State of Kansas exempts profits from the sale of certain state obligations from both corporate and individual income tax, but does not provide for a deduction for a gain recognized on the sale of federal obligations. *See, e.g.*, Kan. Stat. Ann. §§ 32-862; 68-2013; 68-2041. In calculating individual income tax, Connecticut provides for a deduction for the gain on a sale of state securities, but does not provide a similar deduction for a gain from the sale of a federal obligation. *See* Conn. Gen. Stat. § 12-701(a)(20). And prior to the decision below, Pennsylvania's Department of Revenue determined that it was "constitutionally obligated" to exclude gains from the sale of federal obligations for corporate net income tax purposes. *See* Pennsylvania Dep't. of Revenue Tax Update No. 16, at 4 (July 1, 1987).

The decision of the Ohio Supreme Court in this case, if left to stand, will surely encourage other states to follow Ohio's lead and adopt similarly discriminatory tax structures. If this decision is not reversed, any state eager to raise revenues and encourage local investment has every incentive to amend its tax statutes to exempt only the gains from the sale of state obligations from state taxation. Such a result clearly would have a significant negative impact on the market for U.S. Treasury Bonds and other federal obligations. Ohio, Kansas and Connecticut already represent a substantial share of the total market for U.S. Treasury Bonds. Granting permission to other states to discriminate against purchasers of federal obligations will impede the marketability of these securities.

Finally, if there is any doubt that the petition should be granted, this Court should seek the views of the United States concerning the issues presented by this petition, particularly in view of the important federal interest in assuring the continued marketability of United States government obligations.

In sum: Certiorari should be granted to consider these issues of national importance.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

TIMOTHY B. DYK
(*Counsel of Record*)
GREGORY A. CASTANIAS
PAUL R. REICHERT
JONES, DAY, REAVIS & POGUE
1450 G Street, N.W.
Washington, D.C. 20005
(202) 879-3939

CHARLES M. STEINES
JONES, DAY, REAVIS & POGUE
North Point
901 Lakeside Avenue
Cleveland, Ohio 44114
(216) 586-3939

Counsel for Petitioner

November 24, 1997

APPENDIX

SUPREME COURT OF OHIO

NACCO Industries,
Appellants.

v.

Roger W. Tracy,
Commissioner of Ohio,
Appellee.

No. 96-1535
Decided August 6, 1997

APPEAL from the Board of Tax Appeals, No. 95-K-1210.

In 1982, NACCO Industries, Inc. ("NACCO") purchased, for $6,100,003, a fifteen-year U.S. Treasury Bond in the principal amount of $8,000,000. Seven years later, NACCO sold the bond for $7,694,071, of which $126,575 represented accrued, but unpaid, interest. NACCO did not include its $1,467,493 gain from the sale of the bond in the calculation of its 1990 Ohio franchise tax.

NACCO objected to the inclusion of the gain on the basis that the Ohio franchise tax impermissibly discriminated against federal obligations because it exempted gains only from the sale of Ohio public obligations. The Ohio Department of Taxation disagreed, included the $1,476,493 gain in NACCO's net income, and increased the assessment in the amount of $116,202. Upon NACCO's petition for reassessment, the Tax Commissioner affirmed the $116,202 assessment plus $37,343 in interest. The Board of Tax Appeals affirmed the final determination of the Tax Commissioner.

This cause is now before the court upon an appeal as of right.

COOK, Justice.

Ohio corporations calculate their franchise tax on both a net worth basis and a net income basis and pay which-ever produces the greater tax. R.C.5733.06. In this case, the relevant calculation is net income. The initial base for the net income tax is federal taxable income before net operating loss and special deductions. R.C. 5733.04(I). From that figure, Ohio corporations are permitted to "[a]dd any loss or deduct any gain resulting from the sale, exchange, or other disposition of public obligations to the extent included in federal taxable income." R.C. 5733.04(I)(6). For purposes of R.C. 5733.04(I)(6), a "public obligation" is defined as a "public security." R.C. 5733.04(I)(5), 5709.76(D)(5). A "public security," in turn, is defined as "bonds, notes, certificates of indebtedness, commercial paper, and other instruments in writing issued by the *state or a subdivision*." (Emphasis added.) R.C. 5709.76(D)(6).

The effect of these definitions is that gain from the sale of an Ohio obligation is exempt from the Ohio franchise tax,[1] while gain from the sale of a federal obligation is not. We decide here whether this taxing scheme violates Section 3124, Title 31, U.S. Code, or is unconstitutional under the doctrine of intergovernmental immunity as embodied in the Supremacy Clause of the United States Constitution. We conclude that Ohio's corporate franchise tax scheme violates neither the statute nor the constitutional doctrine.

With the famous declaration that "the power to tax involves the power to destroy," *McCulloch v. Maryland* (1819), 17 U.S. (4 Wheat.) 316, 431, 4 L. Ed. 579, 607, Chief Justice John

---

[1] Notably, this exemption from state taxation for state obligations is necessary to comply with the Ohio Constitution. Section 2k(D)(4), Article VIII of the Ohio Constitution exempts from taxation the interest and other income, *including profits from sales*, from bonds issued for the purpose of financing or assisting in the financing of the cost of public infrastructure capital improvements of municipal corporations, counties, townships and other governmental entities.

Marshall announced the doctrine of federal immunity from state taxation. In *McCulloch*, the court considered Maryland's imposition of a tax on notes issued by any bank established without its authority. The only bank falling into that category was the Bank of the United States. Chief Justice Marshall explained that the federal government "though limited in its powers, is supreme within its sphere of action." *Id.* at 405, 4 L. Ed. at 601. Although both sovereigns could impose taxes, the court held that a state does not have authority to tax an instrument employed by the federal government in the execution of its power. *Id.* at 432, 4 L. Ed. at 608.

From *McCulloch* evolved the doctrine of intergovernmental tax immunity. In *Metcalf & Eddy v. Mitchell* (1926), 269 U.S. 514, 521, 46 S. Ct. 172, 173-174, 70 L. Ed. 384, 391, the court explained that "the very nature of our constitutional system of dual sovereign governments is such as impliedly to prohibit the federal government from taxing the instrumentalities of state government, and in a similar manner to limit the power of the states to tax the instrumentalities of the federal government."

In its early development, the doctrine of intergovernmental immunity was construed to insulate not only direct government functions from taxation, but also derivative transactions relating to the performance of governmental functions. 2 Rotunda & Nowak, Treatise on Constitutional Law (2 Ed.1992) 300, Section 13.9. Ultimately, the court expanded the doctrine to prohibit both a state income tax on federal employees and a federal income tax on state employees. *Dobbins v. Erie Cty. Commrs.* (1842), 41 U.S. (16 Pet.) 435, 10 L. Ed. 1022; *The Collector v. Day* (1870), 78 U.S. (11 Wall.) 113, 20 L. Ed. 122.

In modern times, however, the Supreme Court has adopted "a functional approach to claims of intergovernmental immunity, accommodating of the full range of each sovereign's legislative authority and respectful of the primary role of Congress in resolving conflicts between the National and State governments." *North Dakota v. United States* (1990), 495 U.S. 423, 435, 110 S. Ct. 1986, 1994, 109 L. Ed. 2d 420, 433. Abandoning its early

beginnings, the court apparently has eroded the doctrine to the following: "So long as the tax is not directly laid on the Federal Government, it is valid if nondiscriminatory * * * or until Congress declares otherwise." *United States v. Fresno Cty.* (1977), 429 U.S. 452, 460, 97 S. Ct. 699, 704, 50 L. Ed. 2d 683, 691.

By enacting Section 3124, Title 31, U.S. Code ("Section 3124"), Congress has "declared otherwise" on the subject of immunity from state taxation for federal obligations. Because the statutory immunity codified at Section 3124(a) is principally a restatement of the constitutional rule, *Rockford Life Ins. Co. v. Illinois Dept. of Revenue* (1987), 482 U.S. 182, 187-188, 107 S. Ct. 2312, 2315, 96 L. Ed. 2d 152, 159, we first view the case at bar under the statutory immunity and then consider whether the constitutional doctrine of intergovernmental immunity requires a broader exemption.

Section 3124 states, in part:

> "(a) Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except — (1) a nondiscriminatory franchise tax or another nonproperty tax instead of a franchise tax, imposed on a corporation * * * ."

Under this section, the scope of the immunity from state taxation granted by Congress extends only to federal obligations and the interest on such obligations. By its terms, the immunity expressed in Section 3124(a) does not extend to gains from the sale of federal obligations. In contrast, Section 3124(b), Title 31, U.S.Code, regarding federal taxation of federal obligations, incorporates the phrase "tax treatment of gain and loss from the disposition of those [federal] obligations." Congress is generally presumed to act intentionally and purposely when it includes particular language in one section of a statute but omits it in another. *Chicago v. Environmental Defense Fund* (1994), 511

U.S. 328, 338, 114 S. Ct. 1588, 1593, 128 L. Ed. 2d 302, 311. Had Congress intended Section 3124(a) immunity to extend to gains from the sale of federal obligations, it would have expressed that intent in the statute. See *California State Bd. of Equalization v. Sierra Summit, Inc.* (1989), 490 U.S. 844, 854, 109 S. Ct. 2228, 2235, 104 L. Ed. 2d 910, 920.

Moreover, in *Nebraska Dept. of Revenue v. Loewenstein* (1994), 513 U.S. 123, 115 S. Ct. 557, 130 L. Ed. 2d 470, the court upheld a state tax upon interest earned from repurchase agreements involving federal securities under Section 3124. Under these repurchase ("repo") agreements, the owner of the securities agreed to sell and repurchase the securities at a fixed increased price. The original seller retained the interest earned by the securities during the term of the repo agreement. The state exempted from tax the interest paid by the federal government on the federal obligations, but assessed an income tax against the interest paid as a result of the repurchase agreements.

In upholding the state tax, the court found the dispositive question to be whether the interest at issue was earned on the obligations of the United States government. For purposes of Section 3124, the court concluded, the interest was not attributable to redemption of the securities or payment by the United States government. Rather, the interest was income earned as interest on loans to *private parties*. Thus, the court concluded that the income being taxed by the state was not interest from the federal securities and Section 3124 did not prohibit the state from taxing the income.

We similarly find that the dispositive question in this case is whether the income at issue was earned on the obligations of the United States. The income at issue here is not attributable to redemption of the obligations or payment by the United States government. Rather, the income is attributable to a contractual relationship between two private parties. Accordingly, we hold that Section 3124 immunity from state taxation does not extend to Ohio's corporate franchise tax upon the gain from the sales of federal obligations and such a tax is not prohibited by that statute.

We turn now to consider whether the constitutional doctrine of intergovernmental immunity requires any broader exemption than the statute. Before we proceed, however, we are mindful of the Supreme Court's caveat that a "court must proceed carefully when asked to recognize an exemption from state taxation that Congress has not clearly established. We do well to remember the concluding words in *Smith v. Davis* (1944), 323 U.S. 111, 119, 65 S. Ct. 157, 161, 89 L. Ed. 107, 113], which although spoken in reference to the statute, are relevant to our role in applying the constitutional doctrine as well: 'All of these related statutes are a clear indication of an intent to immunize from state taxation only the interest-bearing obligations of the United States which are needed to secure credit to carry on the necessary functions of government. That intent, which is largely codified in § 3701, should not be expanded or modified in any degree by the judiciary.'" *Rockford Life Ins. Co.*, 482 U.S. at 191, 107 S. Ct. at 2317-2318, 96 L. Ed. 2d at 161. "[A]bsent congressional action," the court has emphasized, "the States' power to tax can be denied only under the 'clearest constitutional mandate.'" (Citation omitted.) *United States v. New Mexico* (1982), 455 U.S. 720, 738, 102 S. Ct. 1373, 1384, 71 L. Ed. 2d 580, 594.

In *Rockford Life Ins. Co.*, the court considered whether "Ginnie Maes," financial instruments issued by private financial institutions and guaranteed by the Government National Mortgage Association, were exempt from state taxation by either statutory or constitutional intergovernmental immunity. In considering the constitutional immunity, the court turned to the purpose of the constitutional doctrine. The doctrine, the court noted, is based on the proposition that "the borrowing power is an essential aspect of the Federal Government's authority and, just as the Supremacy Clause bars the States from directly taxing federal property, it also bars the States from taxing federal obligations in a manner which has an adverse effect on the United States' borrowing ability." *Id.* at 190, 107 S. Ct. at 2317, 96 L. Ed. 2d at 160.

The court considered the lack of a fixed and certain obligation by the United States on Ginnie Maes "far too attenuated" from the doctrine's concern with the borrowing power of the United

States to support constitutional immunity. *Id.* The court also considered that none of the proceeds from the sale of Ginnie Maes was received by the federal government or used to finance any federal function. *Id.* at 191, 107 S. Ct. at 2317, 96 L. Ed. 2d at 161.

In *Willcuts v. Bunn* (1931), 282 U.S. 216, 51 S. Ct. 125, 75 L. Ed. 304, the court upheld a federal tax upon gains from the sale of state and municipal obligations after a challenge based upon the doctrine of intergovernmental immunity. There, the court rejected the notion that a prohibition of a tax on the interest payable on state and municipal bonds also prohibited a tax upon the profits derived from a sale of such bonds. *Id.* at 227, 51 S. Ct. at 127, 75 L. Ed. at 308. The court observed that the sale of bonds by their owners "is a transaction distinct from the contracts made by the government in the bonds themselves, and the profits on such sales are in a different category of income from that of the interest payable on the bonds." *Id.* The court further noted that "the tax upon interest is levied upon the return which comes to the owner of the security according to the provisions of the obligation and without any further transaction on his part. The tax falls upon the owner by virtue of the mere fact of ownership, regardless of the use or disposition of the security. The tax upon profits made upon purchases and sales is an excise upon the result of the combination of several factors, including capital investment and, quite generally, some measure of sagacity; the gain may be regarded as 'the creation of capital, industry and skill.'" (Citation omitted.) *Id.* at 227-228, 51 S. Ct. at 127-128, 75 L. Ed. at 308.

The court found particularly persuasive the fact that in a "uniform and long-established practice * * * neither the Federal Government nor the States have found a tax on the profits of the sales of their securities to be a burden on their power to borrow money. So far as we are advised, the Federal Government has not at any time deemed it to be necessary to exempt from taxation the profits realized by owners on the sale of its obligations, with the exception, recently made, of short-term Treasury bills issued

on a discount basis and payable without interest." *Id.* at 232, 51 S. Ct. at 129, 75 L. Ed. at 310.

The *Willcuts* court additionally observed that "it may be doubted whether the prospect on the part of the ordinary investor of obtaining profit on the resale of such obligations is so important an element in inducing their acquisition that a federal tax laid on such profits, in common with profits derived from the sales of other property, constitutes any substantial interference with the functions of state governments. While the tax is laid on gains, there is also a deduction for losses on sales, and whether investors in such securities would consider it an advantage if both provisions were eliminated is a matter of mere speculation. * * * [B]efore we can restrict their application upon the ground of a burden cast upon the State's borrowing power, where the state tax is not laid upon contracts made by the State in the exercise of that power, or upon the amounts payable thereunder, but is laid upon the result of distinct transactions by private owners, it must clearly appear that a substantial burden upon the borrowing power of the State would actually be imposed. But we have nothing but assertion and conjecture." 282 U.S. at 231, 51 S. Ct. at 129, 75 L. Ed. at 310.

From these precedents, it is apparent that the limits of the constitutional doctrine do not extend to a state tax upon gains from the proceeds of a contract between two private parties where there is no demonstrable burden on the federal borrowing power. The nexus between the federal government and the exchange of a federal obligation among private parties is "far too attenuated" from the doctrine's concern with the effect of the tax upon the borrowing power of the United States to support constitutional immunity. *Rockford Life Ins. Co.*, 482 U.S. at 190, 107 S. Ct. at 2317, 96 L. Ed. 2d at 160.

Ohio taxes the proceeds from a transaction between two private parties, a transaction distinct from that of the interest payable on the bonds or the amount payable on the bond itself. The profits from the transaction are realized entirely by the owner of the obligation. None of the proceeds from the sale of the obligations

was received by the federal government or used to finance any federal function. We have no evidence clearly establishing that a substantial burden on the federal government's borrowing power would actually be imposed.

Section 3124 is an indication of an intent to immunize only the federal obligation or the interest on the obligation from state taxation. Until Congress, in its primary role of resolving conflicts between the national and state governments, expressly resolves this conflict to the contrary, we decline to extend the constitutional limits of the immunity doctrine any further than that provided by Section 3124. As a result, we find that neither the statutory nor the constitutional intergovernmental immunity doctrine prohibits Ohio's corporate franchise tax on the gains from the sale of federal obligations.

NACCO argues that our inquiry cannot end here. NACCO contends that under the constitutional doctrine of intergovernmental immunity, any state tax that discriminates against those who deal with the federal government is invalid. We note, however, that under the modern doctrine of intergovernmental immunity, "so long as the tax is not directly laid on the Federal Government, it is valid if nondiscriminatory * * * *or* until Congress declares otherwise." (Emphasis added.) *Fresno Cty.*, 429 U.S. at 460, 97 S. Ct. at 704, 50 L. Ed. 2d at 691. Since we have determined that Congress has declared otherwise, and we have declined to expand the limits of that immunity further, Ohio's franchise tax is valid, regardless of whether it is discriminatory.

Even assuming that we must consider whether the tax is discriminatory, we would nevertheless uphold Ohio's corporate franchise tax. A state tax impermissibly discriminates against federal obligations where it imposes a greater burden on holders of federal property than it does on holders of similar state property. *Id.* The nondiscrimination rule, however, remains rooted in the principle that the state may not obstruct the activities of the federal government. *North Dakota*, 495 U.S. at 437-438, 110 S. Ct. at 1996, 109 L. Ed. 2d at 435. With this principle in

mind, we find persuasive the Tax Commissioner's argument that in order to establish that the Ohio franchise tax discriminates against federal obligations, NACCO must demonstrate that any difference in treatment between state and federal obligations affects or impedes a function of the federal government; in this case, the marketability of federal obligations. To this end, NACCO's expert testified that in his opinion, the exclusion of gain from the sale of state obligations but not federal obligations would place federal obligations at a disadvantage in the market.

At first glance, this argument appears to support NACCO. In analyzing the constitutionality of a state law, however, it is inappropriate for a court to look to the most narrow provision addressing the issue. *North Dakota*, 495 U.S. at 438, 110 S. Ct. at 1996, 109 L. Ed. 2d at 435. Rather, a determination of whether a tax is discriminatory requires an examination of the state's whole tax structure. *Washington v. United States* (1983), 460 U.S. 536, 542, 103 S. Ct. 1344, 1348, 75 L. Ed. 2d 264, 271. Accordingly, we consider that in addition to requiring corporations to "deduct any gain" on the sale of a state obligation, R.C. 5733.04(I)(6) also requires corporations to "add any loss" on the sale of a state obligation in calculating its net income basis.

NACCO's expert testified that the add back of losses from the sale of state obligations but not federal obligations would place federal obligations at a market advantage. However, NACCO's expert could not express an opinion on the relative marketability of the obligations when accounting for both gains and losses from the sale of federal obligations but not on state obligations in the calculation of net income basis. More than mere conjecture or speculation is required to establish that a tax is unconstitutional. *Rockford Life Ins. Co.*, 482 U.S. at 190, 107 S. Ct. at 2317, 96 L. Ed. 2d at 160, fn. 10.

NACCO cites *Memphis Bank & Trust Co. v. Garner* (1983), 459 U.S. 392, 103 S. Ct. 692, 74 L. Ed. 2d 562, as support for the argument that Ohio's tax discriminates against federal obligations. In *Memphis Bank*, the court found a Tennessee state

tax on interest earnings from federal obligations but not on interest earnings from state obligations violated Section 3124. We find this case distinguishable. In *Memphis Bank*, the tax upon the interest of a federal obligation fell within the scope of Section 3124. Thus, Congress already made the determination that a state tax on the interest of federal obligations would substantially affect a function of government. Here, however, the tax on the gain from the sale of federal obligations does not fall within the scope of Section 3124 and NACCO has not otherwise established that the state tax at issue affects a function of government.

We also consider that a state tax is invalid only if it discriminates against the federal government or those with whom it deals. *Id.* at 397, 103 S. Ct. at 696, 74 L. Ed. 2d at 567. Here, the transaction subject to the tax does not arise directly from the relationship between the taxpayer and the federal government. Rather, the transaction subject to the tax arises from a contractual relationship between two private parties. We find this relationship to the federal government too attenuated to invalidate the Ohio franchise tax. Accordingly, we find that NACCO has failed to establish that the franchise tax discriminates against the federal government or those with whom it deals.

Because we find that Ohio's corporate franchise tax violates neither the statutory intergovernmental immunity nor constitutional intergovernmental immunity, we affirm the decision of the Board of Tax Appeals.

Decision affirmed.

MOYER, C.J., and DOUGLAS, FRANCIS E. SWEENEY, SR., PFEIFER and LUNDBERG STRATTON, JJ., concur.

RESNICK, J., concurs in judgment only.

STATE OF OHIO — BOARD OF TAX APPEALS

NACCO Industries,	)	CASE NO. 95-K-1210
Appellant,	)	(FRANCHISE TAX)
	)	
v.	)	
	)	
Roger W. Tracy, Tax	)	Decision and Order
Commissioner of Ohio,	)	June 7, 1996
Appellee.	)	

DECISION AND ORDER

This cause and matter is before the Board of Tax Appeals as a result of a notice of appeal filed on October 27, 1995 by appellant, NACCO Industries. Appellant appeals a final determination of the Tax Commissioner dated September 28, 1995, in which that official denied appellant's objection to a corporate franchise tax assessment for 1990.

It appears that the facts of this appeal are not in dispute. On September 27, 1982, appellant purchased, for $6,100,003, a fifteen year U.S. Treasury bond in the principal amount of $8,000,000. On May 5, 1989, appellant sold this bond for $7,694,071, realizing and recognizing a gain of $1,467,493 on the sale. When appellant filed its 1990 Ohio Corporate Franchise Tax Report, it excluded the gain on the sale of this bond from its tax base as determined under the net income method. Subsequently, the Department of Taxation assessed appellant $116,202.58 in franchise tax, as well as $37,343.81 in interest, based upon the Department's determination that the gain which

appellant had realized on its sale of the bond should have been included within appellant's net income calculation performed under R.C. 5733.05.

Appellant then filed a petition for reassessment, claiming that Ohio's exclusion of gains realized on state obligations while not providing a comparable exclusion for gains incurred on federal obligations was unconstitutional. In his decision, the Tax Commissioner denied appellant's objection, concluding that the gain which appellant incurred on its sale of a U.S. Treasury bond was not excluded by statute. The Tax Commissioner also stated within his final determination that there existed no unconstitutional infirmity in this regard.

It is from this decision that appellant now appeals, specifying the following single error:

> "The Appellee erroneously determined that Appellant is required to include gain realized on the sale of a federal obligation when calculating the value of its issued and outstanding shares of stock, as determined under the net income method of R.C. [section] 5733.05(B). The federal obligation in question is a ten-year U.S. Treasury Bond in the principal amount of $8,000,000. Appellant purchased the bond on September 27, 1982 for $6,100,003 and sold it on May 5, 1989 for $7,567,500 realizing and recognizing a gain of $1,467,497 on the sale.
>
> "Gain from the sale, exchange, or other disposition of public obligations, — e.g., notes issued by the State of Ohio or a subdivision, evidencing the obligation of the State or subdivision to repay money borrowed by, or to pay at any future time other money obligations of, the State or subdivision — are excluded when calculating the value of taxpayer's issued and outstanding shares of stock, as determined under the net income method. Such disparate treatment is in violation of the Supremacy Clause of the U.S. Constitution and 31 U.S.C. [section] 3124."

This matter is now considered by this Board based upon appellant's notice of appeal, the statutory transcript certified by the Tax Commissioner, the record of the hearing conducted on March 26, 1996 and the brief submitted by appellant. At this Board's hearing, appellant presented the testimony of two witnesses: Kenneth C. Schilling, appellant's manager of tax and budgeting, and Dr. Stephen A. Buser, Associate Dean for Budget at the Ohio State University.

At the outset, it is necessary to address a matter upon which the attorney examiner presiding at hearing reserved ruling. Following appellant's voir dire of Dr. Buser, counsel for the Tax Commissioner objected to this Board receiving the testimony of an expert witness whose identity had not been disclosed prior to hearing. Arguing that exclusion was warranted, counsel cited this Board's rule regarding discovery, which became effective March 1, 1996.[2] Ohio Adm. Code 5717-1-11(A), the rule to which the Tax Commissioner's counsel referred, provides in pertinent part:

> "Discovery may be permitted by deposition upon oral examination or written questions; written interrogatories; production of documents or tangible things or permission to enter land or other property; and requests for admissions. The 'Ohio Rules of Civil Procedure' shall be followed for discovery purposes to the extent they are not inconsistent with other board rules, and subject to the following limitations:

---

[2] Counsel also referred to Ohio Adm. Code 5717-1-15(E), which provides as follows:

> "Each party should identify its witnesses and provide copies of the documentary exhibits it plans to offer into evidence (reduced in size, if necessary), to all parties and the attorney examiner, at least seven days prior to the hearing, unless otherwise ordered by the attorney examiner."

Although this rule sets forth the recommended course of practice, its language is not mandatory and there exists no specific sanction for failure to comply. Accordingly, we will limit our discussion to Ohio Adm. Code 5717-1-11(A).

* * * *

"(5) An expert may not be permitted to testify if he or she has not been timely identified prior to hearing. The parties may mutually agree to the exchange of any written reports of expert witnesses to be relied upon by them. Additionally, an expert's report or portions thereof may be excluded from evidence if the report was not made available in a timely fashion to complete a mutually agreed exchange of reports. In all events, the identity of the expert and the written valuation reports shall be provided to counsel seven days prior to hearing, except as otherwise ordered by the attorney examiner."

This is the first occasion in which we have had cause to address a request to exclude the testimony of an expert witness on the basis of an alleged failure to comply with Ohio Adm. Code 5717-1-11(A)(5). Initially, we acknowledge that these rules became effective approximately three weeks prior to the hearing in this matter. As of the date of this hearing, these rules, although made available upon request, had not yet been published in the Ohio Administrative Code. Thus, we find reasonable the representation of appellant's counsel that he was unaware of the specific provision upon which counsel relies.

It is important to point out that the provision for exclusion of an expert's testimony is included within the rule setting forth the manner by which discovery is to proceed before this Board. In this instance, counsel for the Tax Commissioner acknowledged that he had not pursued any discovery of appellant. The purpose of Ohio Adm. Code 5717-1-11(A)(5) is to prevent a party, from whom discovery has been sought, from introducing the testimony of a previously undisclosed expert witness and forcing the party who diligently prepared for hearing to either proceed, perhaps unprepared, or to request a continuance of the hearing.

The language included within this section will not be construed by this Board to permit a party which has not attempted to learn the identity of witnesses through discovery, to achieve, as a sanction, the exclusion of an expert witness at hearing. Cf. *Sindel v. Toledo Edison Co.* (1993), 87 Ohio App. 3d 525,

528-529. This result should be obvious since Ohio Adm. Code 5717-1-11(A)(5) requires only that a party *identify* a witness seven days prior to hearing. Under those circumstances where discovery has not been undertaken, we are unable to find that a party suffers any prejudice, other than that caused by its own inaction, when it learns that the testimony of an expert witness will be offered at hearing.

Finally, it is apparent from counsel's decision to proceed with his cross-examination of appellant's expert, despite having been accorded the opportunity to have the hearing recessed and reconvened at a later time, as well as the questions which he asked, that neither counsel nor the Tax Commissioner was prejudiced in not being advised of the identity of appellant's expert in advance of hearing. Accordingly, for all of the foregoing reasons, counsel's request to exclude the testimony of Dr. Buser is hereby denied.

We now turn to the merits of appellant's appeal. Simply as background, it is noted R.C. 5733.01 imposes a corporate franchise tax upon for-profit corporations for the privilege of exercising their corporate franchise. This tax is first computed on a net income basis and then on a net worth basis, with payment being determined on the higher yielding tax. R.C. 5733.05. See *Gulf Oil Corp. v. Lindley* (1980), 61 Ohio St. 2d 23, 25.

The issue in this case is whether the gain realized by appellant on its sale of a U.S. Treasury bond should be considered when calculating its tax liability under the net income method. Relevant in this instance, R.C. 5733.04(I) provides in part:

> "'Net income' means the taxpayer's taxable income before operating loss deduction and special deductions, as required to be reported for the taxpayer's taxable year under the Internal Revenue Code, subject to the following adjustments:
>
> * * * *
>
> "(5) Deduct any interest or interest equivalent on public obligations and purchase obligations to the extent included in federal taxable income. As used in divisions (I)(5) and (6) of

this section, 'public obligations,' 'purchase obligations,' and 'interest or interest equivalent' have the same meanings as in section 5709.76 of the Revised Code.

"(6) Add any loss or deduct any gain resulting from the sale, exchange, or other disposition of public obligations to the extent included in federal taxable income."

R.C. 5709.76, to which reference is made above, provides in pertinent part:

"(5) 'Public obligations' means public securities, fractionalized interests in purchase obligations, and any obligation or evidence of obligation to pay interest or interest equivalent on public securities or on fractionalized interests in purchase obligations, and does not include purchase obligations.

"(6) 'Public securities' means bonds, notes, certificates of indebtedness, commercial paper, and other instruments in writing issued by the state or a subdivision, or by any nonprofit corporation authorized to issue public securities for or on behalf of the state or a subdivision, to evidence the obligation of the state, subdivision, or nonprofit corporation to repay money borrowed by, or to pay at any future time other money obligations of, the state, subdivision, or nonprofit corporation, and does not include purchase obligations. Public securities may be in the form of either certificated securities or uncertificated securities, as those terms are defined in section 1308.01 of the Revised Code."

Appellant does not claim that the above-cited statutes specifically authorize it to deduct the gain which it realized on the sale of its U.S. Treasury bond from its net income calculation. Instead, appellant argues that Ohio's exclusion of gain realized on the sale of public obligations issued by the state or one of its political subdivisions, without similar provision being made for gain realized on the sale of federal obligations, is discriminatory and thereby violates the United States Constitution and 31 U.S.C. 3124.

Recently, in *Bd. of Edn. of the City of Dublin School Dist. v. Tracy* (Feb. 14, 1996), B.T.A. Case No. 95-K-692, this Board reviewed its role when challenges of a constitutional nature are made. Citing several decisions of the Ohio Supreme Court, we once again acknowledged the well-settled principle that the Board of Tax Appeals, a statutorily created administrative agency, is without jurisdiction to declare a given statute unconstitutional. *Id.* at 5-6. In this same decision, we also concluded that the Board of Tax Appeals is without authority to address constitutional challenges regarding the application of a statute to a given set of facts:

> "[G]iven the more recent decision in *MCI Telecommunications Corp. v. Limbach* (1994), 68 Ohio St. 3d 195, we conclude that the ability to determine whether a statute has been applied in a manner which is unconstitutional is reserved for courts created by Article IV, Section 1, of the Ohio Constitution. When MCI appealed to this Board, it claimed that the Tax Commissioner's application of one statute to it rather than another denied MCI of equal protection of the laws. See *MCI Telecommunications, Corp. v. Limbach* (Jun. 12, 1992), B.T.A. Case No. 88-G-1137, unreported, at 3 (quoting notice of appeal paragraphs four and five). In reserving ruling on these issues, we stated:
>
> "'Further, although this Board received the testimony and evidence relative to the constitutional issues raised, the parties did not brief the issues since the Board of Tax Appeals lacks jurisdiction to decide the issues. * * * Therefore, the only remaining issue presented for resolution is whether the Tax Commissioner properly apportioned the taxable value of MCI's taxable property among the taxing districts in Ohio.' *Id.* at 3-4. (Citation omitted.)
>
> "On appeal, the Supreme Court agreed with the foregoing, holding as follows:
>
> "'The BTA understood its role to be a receiver of evidence for constitutional challenges. Accordingly, it did so, giving the parties wide latitude in presenting the evidence. The BTA

determined no facts on the constitutional questions. The commissioner, however, in her Proposition of Law No. IV, contends that the BTA not only receives evidence in this type of case, but must weigh the evidence and determine the facts necessary for the court's review of the constitutional questions. Since the BTA did not make findings of fact, the commissioner asserts that we should remand the case for the BTA to comply.

"In *Cleveland Gear Co. v. Limbach* (1988), 35 Ohio St. 3d 229, * * *, paragraph three of the syllabus, we held:

"'"The question of whether a tax statute is unconstitutional when applied to a particular state of facts must be raised in the notice of appeal to the Board of Tax Appeals, and the Board of Tax Appeals must receive evidence concerning the question if presented, even though the Board of Tax Appeals may not declare the statute unconstitutional. (*Bd. of Edn. of SouthWestern City Schools v. Kinney* [1986], 24 Ohio St. 3d 184, * * * construed.)"

"'We explained the process, 35 Ohio St. 3d at 232 * * *:

"'"When a statute is challenged on the basis that it is unconstitutional in its application, this court needs a record, and the proponent of the constitutionality of the statute needs notice and an opportunity to offer testimony supporting his or her view.

"'"To accommodate this court's need for extrinsic facts and to provide a forum where such evidence may be received and all parties are apprised of the undertaking, it is reasonable that the BTA be that forum. The BTA is statutorily created to receive evidence in its role as factfinder."

"'Under *Cleveland Gear*, the BTA need only receive evidence for us to make the constitutional finding. This is because the BTA accepts facts but cannot rule on the question. On the other hand, we can decide the constitutional questions but have limited ability to receive evidence. Thus, the BTA receives evidence at its hearing, but we determine the facts necessary

to resolve the constitutional question.' *MCI Telecommunications*, *supra*, 68 Ohio St. 3d at 197-198. (Parallel citations omitted.)" *Id.* at 7-9.

The issue which is presented by appellant's appeal and, in turn, the relief which it requests is beyond the jurisdiction of the Board of Tax Appeals. The applicable statutory provisions do not specifically provide for the exclusion of gain realized on the sale of federal obligations in the calculation of a corporation's tax base under the net income method prescribed by R.C. 5733.05. Accordingly, it is the decision of the Board of Tax Appeals that appellant's specification of error must be overruled. It is therefore the order of this Board that the final determination of the Tax Commissioner must be, and hereby is, affirmed.

I hereby certify the foregoing to be a true and correct copy of the action of the Board of Tax Appeals of the State of Ohio, this day taken, with respect to the above matter.

/s/ Kiehner Johnson
Kiehner Johnson, Chairman